

State of Montana

REPORT TO THE LEGISLATURE

Performance Audit

STATE GOVERNMENT FOOD PURCHASES

The Purchasing Division of the Department of Administration is responsible for making or supervising all purchases of goods and services for state government including purchases of food.

This report presents 11 recommendations for improvements in state government food purchasing, including:

- ▶ Standardize food specifications and schedule university and institution bid openings consecutively (pages 8-12).
- ▶ Require that all bids for quarterly food calls be submitted at the same time (pages 12-14).
- ▶ Review the current meat pricing formula and the cost effectiveness of sales and delivery of meat and dairy products to all institutions currently served by the prison ranch (pages 16-21).
- ▶ Require sufficient information on bidder affidavits to determine if a firm conducts business within Montana (pages 22-26).
- ▶ Review the resident preference system to determine if an overall benefit exists for the state (pages 26-29).

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January 1981

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The Legislative Audit Committee
of the Montana State Legislature:

Herein transmitted is our performance audit of state government food purchases. The purpose and scope of the audit are explained in Chapter I of the report.

This report contains recommendations to the Purchasing Division for improvements in the administration and operation of the central food purchasing function. Included in the audit is an evaluation of direct food purchases made by agencies, prison ranch sales, and the in-state bidder preference.

The Departments of Administration and Institutions have generally concurred with all recommendations made in this report. Their responses are contained beginning on page 30.

We wish to express our appreciation to the directors of the Departments of Administration and Institutions, the Purchasing Division, and the staff of the agencies and the university units visited for their cooperation and assistance.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "James H. Gillett".

James H. Gillett, CPA
Acting Legislative Auditor

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CHAPTER 1

INTRODUCTION

This report is the result of a performance audit of food purchases by state agencies. The Purchasing Division of the Department of Administration is charged with making or supervising the making of all state government purchases. The audit includes a review of the Purchasing Division's administration of state food purchasing and an analysis of agency food purchases.

ORGANIZATION OF REPORT

The report is presented in four chapters. Chapter I presents an introduction to the report and summarizes the objectives and scope of our performance audit.

Chapter II presents background information about Montana's food purchasing procedures. Included is a summary of purchasing laws and Purchasing Division policies, and a description of the various food purchasing procedures.

Chapter III presents an analysis of food purchasing procedures and offers recommendations that we believe would increase cost savings to the state.

Chapter IV examines the preference given to in-state bidders. Included are recommendations to modify the administration of the preference system.

Scope of Audit

The audit focused on the effectiveness and efficiency of food purchasing activities of the Purchasing Division. The audit also included an examination of purchases made by institutions and by university units. In addition to audit work at the Purchasing

Division, we visited institutions and universities and interviewed food vendors. Two random statistical samples were selected to help appraise food purchasing by the Purchasing Division and by other state agencies. A sample of transfer warrant claims (TWC) and no-warrant transfers was selected from specific expenditure codes for food commodities. These transactions include those routed through the Purchasing Division, as well as those handled directly by the agencies. A sample was also taken of the Purchasing Division's primary food purchasing method known as the Requisition Time Schedule (RTS). Dollar volumes of various categories of food purchases were projected from our TWC sample and included in this report.

The audit did not include an evaluation of contracted food services which are exempt from competitive bidding requirements.

PREVIOUS PURCHASING AUDITS

The centralized purchasing activity of the Department of Administration was audited in 1974 and 1979 by this office. Both of these reports are referred to in this report. While this audit did not duplicate the previous audits, several areas covered in the past reports are also discussed in this report as they relate to food purchases.

CHAPTER II

BACKGROUND

In fiscal year 1979-80, at least \$5.4 million was expended by state agencies for food items. The majority of food purchases were made by university units and by state institutions.

Section 18-4-401, MCA, states that the Department of Administration "shall make or supervise the making of all purchases, leases, or rentals of goods and services for the legislature, the supreme court, and each state agency, institution, and official." Food purchasing procedures are explained in the "Purchasing Procedures Manual" and in the "Requisition Time Schedule (RTS) and Local Purchasing Policy". These documents are issued by the Purchasing Division (hereinafter referred to as the division) of the Department of Administration. The division's food purchasing policies require that "all perishable supplies (exclusive of fresh fruits and green vegetables) shall be ordered as needed on a quarterly basis." Requisitions are required for groceries, meats, poultry, fish, dairy by-products and dairy fluid milk products for the Montana University System and for state institutions.

Division policies allow agencies to make purchases at the local level for items less than \$200 whenever the commodity is not available on a term contract. If an agency enters into an agreement with the division, purchases by competitive procedures for items up to \$300 can be made.

REQUISITION TIME SCHEDULE (RTS)

There are several different ways that food is purchased by state agencies. The majority of food purchases are under the

RTS, with purchases totalling at least \$2.9 million in fiscal year 1979-80. The RTS consists of dates throughout the year which are deadlines for all agencies to have requisitions for various commodities to the Purchasing Division. Approximately 85 different commodities with either annual, semi-annual, or quarterly calls for quotations are covered under these buys.

There are 11 call dates for food purchases. Eight are quarterly calls, four for the university units and four for the state institutions. Each of these quarterly calls is further broken down to the commodities of groceries, meats, poultry, fish, dairy by-products and dairy fluid milk products. Three call dates are annual calls for sugar, canned goods, coffee and tea. A final annual call is for candy, nuts, and fruit for Thanksgiving and Christmas, which is used by some state institutions.

The Purchasing Division receives agencies' requisitions for RTS purchases and prepares request for quotation forms known as price requests (PR). The PR is a formal, sealed bid process in which all vendors on the appropriate bidders list are given a chance to submit a bid. There are three university units that use the RTS for food purchases - Montana State University, University of Montana, and Northern Montana College. During fiscal year 1979-80 there were 102 PRs opened for these university units and 61 for state institutions.

AGENCY PURCHASES

Another way that state agencies purchase food is to buy directly from the vendor. During fiscal year 1979-80 agencies directly purchased at least \$500,000 in food. Direct agency

purchases include: (1) produce (which is exempt from the time scheduled contracts); (2) purchases that were not anticipated for the RTS; and (3) purchases that reasonably cannot be placed on the RTS.

Produce is normally purchased by university units and state institutions on a weekly basis. Most of the agency personnel we interviewed said they get telephone or written quotations from the produce vendors in their area. Agencies place orders based on the lowest bid on an item-by-item basis. For fiscal year 1979-80 agencies purchased a minimum of \$215,000 in produce.

Direct agency purchases other than produce amounted to a minimum of \$284,000 in fiscal year 1979-80. These purchases may have been made because of inadequate planning by the agencies or because of circumstances over which they had no control. Some agencies make direct purchases on blanket purchase orders. Blanket purchase orders are placed with a specified vendor and usually have a maximum dollar value and time limit. In addition, agencies often can increase the volume of an order on an existing state purchase order. These dollar amounts do not show up as direct agency purchases but rather as RTS purchases since they have purchase order numbers.

OTHER PURCHASING METHODS

There are several other methods used by agencies and by the Purchasing Division to purchase food. Food term contracts are used to establish a specific source of supply for a given product for a designated period of time. Term contracts have either pre-specified unit prices or percent discounts from price

lists. Term contracts offer the advantage of competitively bidding quantity price discounts, while allowing agencies to purchase goods on an "as needed" basis.

The Purchasing Division established four food term contracts for fiscal year 1979-80: two are for fountain syrup for the University of Montana; one is for dietetic products for the university units and the state institutions; and one is for candy bars and gum supplies for Warm Springs State Hospital's canteen. These four term contracts totalled approximately \$57,000 for fiscal year 1979-80.

Some food purchases for fiscal year 1979-80 were not on the RTS but were covered by state purchase orders. These purchases were for items that agencies did not include on their normal scheduled calls. Agencies submitted requisitions for these items rather than purchasing them directly. These purchases amounted to at least \$37,000 in fiscal year 1979-80.

The prison ranch operation supplies meat and milk products to most state institutions. State institutions order directly from the prison ranch and usually receive deliveries on a weekly basis. There is a predetermined unit price for each product that the prison ranch supplies. For fiscal year 1979-80 the prison ranch supplied approximately \$1 million in meat and milk products.

The final purchasing method for food is used by Eastern Montana College, Western Montana College, and Montana College of Mineral Science and Technology. These units contract for their

food service. Approximately \$981,000 was expended on these three contracts in FY 1979-80. The contractor manages and operates the food service facilities of these units. Service includes the procurement, preparation, and serving of food and beverages to students, faculty, staff, employees, and guests of these units. Contractors also cater university functions.

Contracts for food services are established directly by the university units. Based on an opinion by the Attorney General, these contracts do not have to be competitively bid.

MISCODED EXPENDITURES

A computer printout of all vendors receiving payments under food expenditures codes showed several examples where agencies are coding nonfood items to food expenditure codes. For example, one agency had payments totalling approximately \$174,000 to two vendors during fiscal year 1979-80 for nonfood items. Miscoded items that appeared in our TWC sample were not used when making dollar volume projections for this report.

CHAPTER III

IMPROVEMENTS IN FOOD PURCHASING

Our review of state food purchases revealed concerns in three areas where food purchasing could be more effective.

1. Requisition Time Schedule Purchases
2. Direct Agency Purchases
3. Prison Ranch Sales

The intent of the following sections is to briefly discuss these areas.

REQUISITION TIME SCHEDULE PURCHASES

The majority of the state's food purchases are directed by the Purchasing Division using the Requisition Time Schedule (RTS) process. Approximately 55 percent of food purchases are accomplished by this method (not including contracted food services). The RTS process could be changed to make it more efficient in the following areas:

1. Time Delays
2. Standardized Specifications
3. Bid Opening

Time Delays

Our review of food purchases included analyzing a random sample of scheduled calls opened during fiscal year 1979-80. This analysis showed that it takes an average of 64 days from the date requisitions are due to the division (call date) until purchase orders are awarded and mailed to vendors and agencies. This time is broken down to approximately 44 days from the call date to

the bid opening date, and 20 days from bid opening to purchase order mailing.

Even after the purchase order has been mailed, additional delays occur because vendors need several weeks to receive goods from their brokers. Vendors also need time to make deliveries to requesting agencies.

Time delays in this process cause several problems for agencies and vendors. Agency personnel that we interviewed noted the following problems:

- Needs must be predicted too far in advance.
- Products often arrive after the quarter begins.
- Extra inventories must be carried.
- Products often arrive before agencies get their copies of the purchase orders. This prevents verification of orders and causes delay in payment of vendors.

Vendors that we interviewed complained of too little time to submit bids and late payments by the agencies. Several vendors said they often do not receive payment until 60 days or more after delivery. At least part of the reason for late payment is that agencies need to have the purchase orders before payments can be processed.

In an attempt to expedite time schedule food buys, the division has requested that agencies submit their requirements on price request forms rather than on requisition forms. These forms are then combined with a cover page and contract terms and conditions, and are sent directly to vendors for bids. No retyping of these forms is necessary. When used, this procedure

has significantly reduced typographical errors which previously plagued food buys. Processing time savings have also occurred, but the division buyer has chosen to allow vendors more time to submit bids rather than to shorten total processing time.

A second step being considered by the division is to release purchase orders to agencies and vendors before funds are encumbered through the Accounting Division. Our sample of food purchases showed that encumbering funds added an average of just over two days to total processing time.

Even with these two modifications, processing time will continue to be a problem. One reason the RTS process is time consuming is because the procedures of the Purchasing Division are performed manually. Bid organization, invitation for bid, analysis, award, and preparation of purchase orders are completed by hand. Each bid invitation is individually addressed by secretaries from a bidders list determined by the buyer. Buyers hand tabulate, analyze, and award bids. Time taken to perform these tasks is dependent upon the complexity of the purchase. Food purchases tend to be complex because of the large number of items that must be ordered. Clerical staff time is also significant in these areas. Typing of PR forms and purchase orders for food purchases is time consuming because of the large number of scheduled calls (163 opened in fiscal year 1979-80) and because agencies need dozens of food items. For example, a pre-requisition form listed almost 200 items just in the categories of canned goods and groceries.

Problems with manual processing and the large volume of repetitive typing were discussed in the 1979 purchasing audit. The audit report recommended that the Purchasing Division request funding for a computerized management information system (MIS). The report indicated the MIS could produce a potential time savings of 12 working days for the average scheduled call. The report also recommended that the division determine if automatic typing equipment is cost effective. The Department of Administration concurred with these recommendations and has submitted an appropriation request for a computerized MIS for the 1981 legislative session. The proposed system would also have some automatic typing capabilities.

Standardized Specifications

Automatic typing equipment and a management information system would enable the Purchasing Division to reduce processing time for food purchases. Standardizing items purchased by all agencies would allow optimal usage of these systems. With standardized specifications, agencies would only have to indicate items wanted and would not be required to submit separate product specifications. Complete specifications could be prepared by the division with automatic typing equipment, thus eliminating the need for agency preparation.

Agencies currently specify different grades, brands, quantities, and sizes which necessitates different specifications. Establishing consistent specifications between the universities and institutions would allow vendors to place larger orders with brokers, thus increasing the availability of volume discounts to the state. To enable vendors to place these larger orders would

require having university and institution bid openings scheduled consecutively. Currently, university and institution bid openings are scheduled about a month apart. Automatic typing equipment and the MIS would be required for the division to complete the processing of university and institution bid openings within a short time frame. Purchasing Division management agrees that standardized specifications and scheduling major food purchases closer together will enhance volume discounts. Plans are being made to schedule university and institutional food purchases within a week of each other.

The division should require universities and institutions to standardize food specifications where possible. The division should also schedule university and institution bid openings consecutively to allow vendors to combine orders.

RECOMMENDATION #1

WE RECOMMEND THE PURCHASING DIVISION:

- A. STANDARDIZE FOOD SPECIFICATIONS WHERE POSSIBLE.
- B. SCHEDULE UNIVERSITY AND INSTITUTION BID OPENINGS CONSECUTIVELY.

Bid Opening Process

Food purchases are made on a quarterly basis by both the university units and state institutions. Bids for participating university units are opened approximately one month before bids for the institutions. Both of the bid openings occur over a three-day period. For example, University of Montana food bids

may be opened the first day, with Montana State University and Northern Montana College bids being opened the second and third days, respectively. This same procedure is repeated for institutional food buying, with several institutions' bids opened each day.

Bid openings are attended by food service personnel from the university units and representatives of some vendors. Vendors usually attend bid openings only for the university units. University personnel believe it is necessary to attend bid openings in order to make certain that product specifications are clear to vendors. Vendor representatives attend the openings to assure they understand specifications and to review competitor bids from the first day's opening. Bids are submitted each day of the three-day period. Vendors then have the opportunity to adjust bids for the second and third days.

University personnel state that prices received on the second and third day bid openings are lower than the first day, although this is not always the case. The order of opening is therefore rotated between the two major university units.

Vendors attending bid openings have the advantage of reviewing opponents' bids and modifying bids accordingly. Those vendors who cannot afford to spend two or three days a quarter in Helena for bid openings are at a disadvantage. These vendors either submit bids for the three day process in advance, or do not bid. This places a burden on those firms unwilling or unable to send a representative to Helena.

The theory of the sealed bid procedure involves giving each vendor an equal opportunity to bid on state purchases. Holding a three-day opening process each quarter and allowing vendors attending the openings to modify bids throughout the period eliminates the equal treatment concept. The division should have the bid return cutoff date as the first day of the bid opening process to remove this bidding barrier and allow all vendors to compete on an equal basis. To achieve this, the division may have to request a single call for bids for the university units and one for the institutions.

RECOMMENDATION #2

WE RECOMMEND THE PURCHASING DIVISION REQUIRE THAT ALL BIDS FOR QUARTERLY FOOD CALLS BE SUBMITTED AT THE SAME TIME.

DIRECT AGENCY PURCHASES

In December 1979, the division issued a new RTS and local purchasing policy. It also changed its past policies concerning direct agency purchases. The dollar limit below which agencies could buy directly was increased from \$150 to \$200. This amount increases to \$300 if agencies agree to use competitive bidding procedures. Dollar limits for Montana State University, University of Montana, and Eastern Montana College remained at \$1,000.

A substantial change in the direct purchasing policy now allows agencies to buy items directly that are on the RTS if the price is below the dollar limit noted above. With the previous

local purchasing policy, RTS items could only be purchased on scheduled calls, except for documented emergencies. The result of the policy change is that agencies can buy food items without following the time schedule as long as they stay below the dollar limit. Our transfer warrant claim sample showed several agencies buying food items directly that could have been ordered on the RTS. It was not possible to determine if individual direct purchases were over the dollar limits. We project that these direct purchases amounted to at least \$242,000 in fiscal year 1979-80. Some of these agencies have local vendors who they buy food from on almost a daily basis. As an example, one agency had 28 invoices for mostly food items from a single vendor over a 31-day period.

Some agencies, other than universities and institutions, also make some food purchases. Normally, these agencies purchase food in such small quantities that it is not possible for them to participate in the RTS. Agencies need direct purchasing authority in these instances.

Food is included on the RTS because it is a commodity whose usage can normally be predicted. The RTS was established because of the basic premise that volume buying reduces costs. Normally, the larger the individual order the greater the price discount. Volume buying is hindered when agencies do not correctly anticipate needs in advance. Order sizes are also reduced when agencies increase existing purchase orders. Some of these purchases are true emergencies but many are due to lack of planning.

As agencies become aware of the new division policy, direct agency purchases can be expected to grow, thus reducing RTS savings. The division should change the local purchasing policy so that it only applies to cases where agencies cannot anticipate needs (emergencies). Also, those agencies buying minimal quantities of food cannot always utilize the RTS and should be allowed to continue to buy food items below the dollar limits directly.

RECOMMENDATION #3

WE RECOMMEND THE PURCHASING DIVISION ALLOW DIRECT AGENCY FOOD PURCHASES ONLY IN EMERGENCY SITUATIONS AND FOR THOSE AGENCIES THAT CANNOT PREDICT FOOD NEEDS IN ADVANCE.

PRISON RANCH SALES

In 1977 the prison ranch was established as a self-supporting entity by the legislature. The 1978 Governor's Annual Report states: "meat and dairy products . . . are provided at a rate of 10 percent below market value." Prices charged for meat and certain dairy items are set by the Prison Ranch Commodities Pricing Board. This board is made up of several division administrators from the Department of Institutions.

Nineteen percent of all state food purchases, or just over a million dollars, were made from the prison ranch in fiscal year 1979-80. Beef, pork, and dairy products were supplied to state institutions through the ranch. Illustration 1 shows total ranch sales by category.

PRISON RANCH SALES
FISCAL YEAR 1979-80

	<u>Beef</u>	<u>Pork</u>	<u>Dairy</u>	<u>Total</u>
Total Sales	\$540,220	\$166,926	\$460,670	\$1,167,816

Source: Department of Institutions financial data.

Illustration 1

Eight of the ten institutions attached to the Department of Institutions buy meat from the prison ranch, and seven also purchase dairy products. Two institutions, Eastmont Training Center and the Veterans' Home, buy these items from private vendors and claim they receive better prices. Statutes dealing with institutional industries (section 53-1-301(4), MCA) give the Department of Institutions authority to require institutions to purchase needed goods from other institutions.

Price Comparison

A price comparison made between prices charged by the prison ranch and those gained through competitive bidding show the ranch prices for meat to be generally higher in FY 1979-80 than prices obtained through the Purchasing Division. For this reason, we analyzed the methods used to set prices for prison ranch products.

MEAT
PRICE COMPARISON
 Fiscal Year 1979-80
 Product Prices Per Pound

<u>Product</u>	<u>Quarter</u>	<u>Prison Ranch</u>	<u>Montana State University</u>	<u>Northern Montana College</u>	<u>Percentage Differences Between Prison Ranch and Northern</u>
Hamburger	I	\$1.57	--	--	--
	II	1.57	\$1.24	\$1.18	33%
	III	1.26	1.32	1.35	(7%)
	IV	1.41	1.28	1.38	2%
Liver	I	.85	--	--	--
	II	.85	1.03	.83	2%
	III	--	--	--	--
	IV	.97	1.07	1.07	(9%)
Bacon	I	1.29	--	--	--
	II	1.29	.84	.91	42%
	III	1.02	.95	1.00	2%
	IV	1.04	.78	.89	21%
Roast Beef	I	1.57	Comparison	1.85	(15%)
	II	1.57	Not	1.59	(1%)
	III	2.28	Possible	1.59	43%
	IV	1.96		1.78	10%

Source: Compiled by the Office of the Legislative Auditor.

Illustration 2

Illustration 2 shows a comparison between the prison ranch and prices gained through the Purchasing Division for Montana State University and Northern Montana College. Percentage differences shown are direct comparisons between prices charged by the prison ranch and those received by Northern Montana College through competitive bidding. Those percentages in brackets indicate prices charged by the prison ranch are lower than prices received by Northern. The price differentials are conservative because Northern Montana College buys smaller

quantities of meat than six of the eight institutions which buy from the prison ranch. Northern's location at Havre also places it off main delivery routes.

Generally, higher prices were charged by the prison ranch over the time period reviewed for the four products compared. These four products represent 47 percent of total meat sales, or just over \$300,000. Direct comparisons show that the prison ranch has failed to provide user institutions with prices that are equal to those obtained by the Purchasing Division. If the four state institutions buying the most meat from the prison in fiscal year 1979-80 had received prices equal to Northern's, a cost savings of approximately \$25,000 would have been achieved for the four products compared.

It should also be noted that prices charged by the ranch for the fourth quarter of FY 1979-80 were set at the level indicated by the current pricing formula. Therefore, the policy of pricing meat products 10 percent below the formula determined market value has not been followed.

Operational data provided by the Department of Institutions show that both the beef and pork operations at the prison ranch lost money in FY 1979-80. Losses in the beef sector were attributed to unusually high operating costs. Profits for the dairy were sufficient to make the overall ranch profitable.

Determining Market Price

Market price is determined by the ranch pricing board and is set as the average of prices received by Eastmont Training Center, the School for Deaf and Blind, St. Peter's Community

Hospital, and Silver Bow General Hospital. Both major university units were excluded from the pricing formula because of the volume of meats purchased.

Quantities of meat purchased by these four organizations is limited when compared to the larger state institutions. Eliminating prices received by the two large university units weighs the pricing formula toward higher prices because larger buyers are not included. Limiting the market price formula to these four organizations does not adequately reflect true market prices achievable through competitive bidding for quantities of meat purchased by the larger state institutions.

The Purchasing Division should supply prices obtained through the bidding process to the prison ranch pricing board for its consideration in establishing prices. Actual market prices cannot be fairly determined unless both large and small quantity purchases are included in the pricing formula.

A factor in price setting is that all institutions are charged the same price per pound for various meat and dairy products bought through the prison ranch. Transportation costs for delivery of the products are included in ranch administrative costs. This procedure spreads delivery costs over all sales and, in effect, subsidizes sales to institutions farthest from the ranch.

Department of Institutions officials should review the cost effectiveness of establishing a set price regardless of the delivery point. The overall cost effectiveness of delivering ranch products to all institutions presently served should also be examined after proper price levels have been set. These prices should also

be periodically compared to prices obtained through the Purchasing Division. If it is determined that the prison ranch cannot compete with open market prices for certain agencies, the department should allow those agencies to buy meat products through the Purchasing Division in an effort to reduce administrative costs.

RECOMMENDATION #4

WE RECOMMEND THE PURCHASING DIVISION PROVIDE QUARTERLY PRICES FOR MEAT ITEMS TO THE PRISON RANCH COMMODITIES PRICING BOARD.

RECOMMENDATION #5

WE RECOMMEND THE DEPARTMENT OF INSTITUTIONS:

- A. USE MEAT PRICES OBTAINED THROUGH THE PURCHASING DIVISION IN THE PRISON RANCH MEAT PRICING FORMULA.
- B. ESTABLISH PRICING FORMULAS THAT REFLECT DELIVERY COSTS TO INDIVIDUAL INSTITUTIONS.
- C. REVIEW THE COST EFFECTIVENESS OF SALES AND DELIVERY OF MEAT AND DAIRY PRODUCTS TO ALL INSTITUTIONS CURRENTLY SERVED BY THE PRISON RANCH.

CHAPTER IV

IN-STATE BIDDER PREFERENCE

Montana awards a 3 percent bidder preference to all state resident vendors or to those manufacturing or producing goods in-state. The preference is granted to promote in-state buying and thus to encourage economic expansion. Individuals or companies wishing to receive the 3 percent preference must file an affidavit with the Purchasing Division. The affidavit requires information on the length of residency and a list of owners, if the firm is a partnership or corporation. Firms must operate in Montana for one year prior to receiving the preference. Those firms requesting the preference based on manufacturing or production operations must show a processing plant in Montana. Corporations applying for the preference must have a majority of ownership within the state. Based on data related to residency and ownership, the Purchasing Division determines which firms will be granted the preference.

CRITERIA FOR BIDDER PREFERENCE

Section 18-1-103(3), MCA, states:

"Domestic corporations organized under the laws of the State of Montana are prima facie eligible to bid as residents, . . ."

A 1979 memorandum to Purchasing Division buyers, from the division administrator, addresses the awarding of the in-state preference. This memorandum quotes the above statute and states that a company incorporated in Montana meets residency requirements for the preference. Division employees making

decisions on whether or not a firm qualifies rely almost exclusively on information supplied by the vendor. A check may be made with the Secretary of State's Office to ensure the firm is incorporated in Montana, but no other data is reviewed. Pertinent information submitted by the vendor is limited to the state of incorporation and the names and addresses of corporate directors and those who own 5 percent or more of the firm. No data is required on facilities operated in-state or the number of employees hired by the company.

Preference Award

Montana's bidder preference law was a major topic of the 1974 purchasing audit by this office. That audit detailed numerous problems with the awarding of the preference, including awarding the preference to food vendors. Complaints continue to be made that the preference is being inequitably applied. Specifically, complaints have been made that out-of-state firms have set up "dummy" Montana corporations and are illegally receiving the preference.

To determine the validity of these complaints, several major food suppliers receiving the preference were examined. Preference affidavit information supplied by these firms was reviewed and compared with: Articles of Incorporation on file at the Secretary of State's Office; wage data reported to the Employment Security Division; and workers' compensation insurance reports on file with the Workers' Compensation Division. These three sources were reviewed to determine the extent of business conducted in Montana by major suppliers of food.

Illustration 3 details information from a review of four food vendors.

FOOD SUPPLIERS' IN-STATE BUSINESS ACTIVITY

<u>Vendor</u>	<u>Incorporated In Montana</u>	<u>Number of Employees Reported</u>	<u>Maintain Workman's Compensation Insurance</u>	<u>Sales In FY 1980 to State</u>
A	Yes	0	No	\$ 1,307,892
B	Yes	0	No	202,445
C	Yes	0	No	184,187
D	Yes	12	Yes	47,430

Source: Compiled by the Office of the Legislative Auditor.

Illustration 3

Vendors indicated in the above illustration rank 1, 4, 5, and 6 in terms of total dollars of food sales processed through the Purchasing Division. Firms A, B, and C shown in Illustration 3 list no Montana employees nor do they maintain workers' compensation insurance in-state. Vendor D shows Montana employees and coverage under workers' compensation insurance. Three of the four firms are associated with other companies that operate warehousing facilities and distribution systems in-state, and hire Montana employees. However, employees are officially working for companies other than those selling to the state. Companies A, C, and D have a close working relationship with the firms which have not applied for the preference and may well not qualify. These vendors, which receive the preference, appear to be subsidiaries of companies which actually maintain the warehousing facilities and hire in-state employees. Operations of companies receiving the preference, other than with state agencies, are

carried on through the parent firm. Business addresses and all advertising list the parent firm.

Only one firm, vendor B, shows no connection to another firm maintaining an in-state operation. This company retains a post office box in Helena and an answering service in Missoula, but does not advertise as a food supplier in either of these two cities. This same company was described in the 1974 audit as technically qualifying as a Montana corporation, but whose business is exclusively conducted by non-resident interests. We found no change in this situation.

Without information on the level of business activity in Montana, it is impossible for Purchasing Division personnel to determine if a firm is a valid operation or if it was formed strictly to obtain the preference. The Report and Affidavit of Bidder on State Contracts form should therefore be modified to collect the necessary information to make this decision. The number of Montana employees and the addresses of company facilities are two indicators of valid in-state operations by the bidder requesting the 3 percent preference. Comparing this information with that already required will allow the Purchasing Division to determine the degree of business activity conducted in Montana, although it will not prove resident ownership.

Our review of vendor reports also showed that several affidavits were received and approved in the early 1970's. One affidavit had not been updated since 1961. In at least two of the files examined, ownership of the firm had changed. Previous decisions on granting the preference should be periodically updated to ensure continued compliance with criteria for the

preference. Vendors should be asked to complete updated affidavit forms every three or four years.

RECOMMENDATION #6

WE RECOMMEND THE PURCHASING DIVISION:

- A. REQUIRE SUFFICIENT INFORMATION ON THE REPORT AND AFFIDAVIT OF BIDDER ON STATE CONTRACTS FORM TO DETERMINE IF THE REQUESTING FIRM CONDUCTS BUSINESS WITHIN MONTANA.
- B. PERIODICALLY REQUEST UPDATED AFFIDAVIT REPORTS.

EFFECT OF BIDDER PREFERENCE

Granting a preference to in-state bidders has a definite impact on state food purchases. From a sample of 24 scheduled food purchases, we found that only 3 of 74 bids came from firms which were located out-of-state. A representative from a major vendor from Spokane stated that his firm would not attempt to bid on state food purchases as long as the preference system continued. This firm is extensively involved in food sales in western Montana.

We contacted eight food vendor representatives to gain their opinions on the preference. All vendors indicated that the 3 percent preference did make a difference in the awarding of food contracts, especially meat purchases. Only the vendor showing no in-state operations thought that the 3 percent preference should be eliminated. Other firms wished to retain the preference

system, although they noted that out-of-state competition was restricted and the state paid higher prices because of the preference.

Several company representatives commented that even without the preference, their firms would have an advantage over out-of-state firms because of in-state warehousing facilities. All of the company representatives contacted said they believed all firms maintaining in-state warehousing and distribution facilities should be granted the preference, regardless of the residency of owners.

Administration of the Preference Law

Enforcement of Montana's bidder preference law will have to be greatly increased in order to assure compliance with residency requirements. Purchasing Division staff will have to be made available to review the hundreds of preference affidavits filed with the state. Our analysis of food vendors indicates that complaints about out-of-state owned firms setting up "dummy" in-state corporations to get the preference have merit. Although other industries are not greatly impacted by the 3 percent preference, all vendor affidavits should be examined to ensure consistency and compliance with state law. Effective criteria for determining whether or not a firm meets requirements of the law need to be developed and placed in the administrative rules of the division. All of these procedures will be time consuming and costly for the state and should be weighed against benefits derived from the preference.

Other States

North Dakota and Wyoming have enacted retaliatory preference laws against Montana businesses. North Dakota adds 3 percent to Montana bids; the same as Montana's in-state bidder preference. Wyoming places a 5 percent penalty on bids from Montana firms. Discussions with purchasing agents from these two states indicated that the retaliatory preference is enforced and that it has had an impact on bids from Montana firms. Neither of these two states maintains an in-state preference law, only a retaliatory preference is being utilized. A survey of ten western states shows that the only other state retaining a preference law on all bidding is New Mexico. Several states give preference to in-state vendors in the event of tie bids.

Contrary to encouraging economic activity and promoting in-state businesses, the preference law has had the effect of hindering trade with neighboring states. With two of four states bordering Montana enacting retaliatory legislation, expansion into these neighboring markets is restricted. Any benefit to resident vendors gained by the preference will again have to be weighed against the loss of sales by Montana firms in these two states.

The need to establish clearer criteria for award of the bidder preference, the administrative costs of enforcement, the limitations on competition, and doubts over whether the economic impact is positive or negative point to the necessity to review the preference system. Purchasing Division management should therefore review costs associated with enforcing the preference and relate these to benefits gained. Determining benefits of the

preference would require soliciting vendor opinions, and reviewing the effect of the preference on past bid openings. Based on this analysis, department officials should review the granting of the preference and recommend legislation to either modify or eliminate the preference system.

RECOMMENDATION #7

WE RECOMMEND THAT PURCHASING DIVISION MANAGEMENT REVIEW THE PREFERENCE SYSTEM TO DETERMINE IF AN OVERALL BENEFIT EXISTS FOR THE STATE.

DEPARTMENT OF ADMINISTRATION
PURCHASING DIVISION



THOMAS L. JUDGE, GOVERNOR

CAPITOL STATION

STATE OF MONTANA

(406) 449-2575

HELENA, MONTANA 59601

December 31, 1980

Mr. Scott A. Seacat
Performance Audit Manager
Office of the Legislative Auditor
State Capitol
Helena, Montana 59620

Dear Mr. Seacat:

The enclosed response is submitted by the Department of Administration, Purchasing Division in reply to the Performance Audit on State Government Food Purchases, presented by the Office of the Legislative Auditor on December 17, 1980.

Chapter III, Page 12

RECOMMENDATION #1

We recommend the Purchasing Division:

- A. Standardize food specifications where possible.
- B. Schedule university and institution bid openings consecutively.

COMMENTS

- A. We concur with this recommendation. The Purchasing Division has expanded the use of pre-requisition forms whenever the projected requirements of the Agencies could be determined. The categories of meats, canned goods and groceries were incorporated in this program during 1980 and increased the standardization of food specifications, volume buying and reduced purchase prices.
- B. Quarterly food purchases for universities and institutions are now scheduled to be opened on consecutive weeks. This policy encourages the receipt of volume discount prices and competitive bidding.

RECEIVED

DEC 31 1980

MONTANA LEGISLATIVE AUDITOR

Chapter III, Page 14

RECOMMENDATION #2

We recommend the Purchasing Division require that all bids for quarterly food calls be submitted at the same time.

COMMENTS

We concur with this recommendation. The policy of opening all quarterly food calls at the same time will be implemented as the Division's present manual processing capabilities are refined or processing time can be reduced by incorporating automated purchasing procedures.

Chapter III, Page 16

RECOMMENDATION #3

We recommend the Purchasing Division allow direct agency food purchases only in emergency situations and for those agencies that cannot predict food needs in advance.

COMMENTS

We concur with this recommendation.

On May 1, 1980 the Purchasing Procedures Manual was revised to require a requisition form be prepared for already received orders, confirming the agencies' compliance with delegated purchasing authority.

The current Requisition Time Schedule and Local Purchasing Policy, issued December 19, 1980, further clarifies that categories of purchase can be ordered directly only if the amount is less than the local purchasing limitations and not listed on the Requisition Time Schedule or available from a Term Contract. Lack of reasonable planning cannot be considered as proper justification for emergency orders.

Chapter III, Page 21

RECOMMENDATION #4

We recommend the Purchasing Division provide quarterly prices for meat items to the Prison Ranch Commodities Pricing Board.

COMMENTS

We concur with this recommendation. Quarterly meat prices have regularly been provided to the Commodities Pricing Board and are readily available for review.

Chapter III, Page 21

RECOMMENDATION #5

We recommend the Department of Institutions:

- A. Use meat prices obtained through the Purchasing Division in the Prison Ranch meat pricing formula.
- B. Establish pricing formulas that reflect delivery costs to individual Institutions.
- C. Review the cost effectiveness of sales and delivery of meat and dairy products to all Institutions currently served by the Prison Ranch.

COMMENTS

We concur with the recommendations. The Purchasing Division will be happy to provide any comparative procurement information to the Department of Institutions.

Chapter III, Page 26

RECOMMENDATION #6

We recommend the Purchasing Division:

- A. Require sufficient information on the Report and Affidavit of Bidder on State Contracts Form to determine if the requesting firm conducts business within Montana.
- B. Periodically request updated Affidavit Reports.

COMMENTS

We concur with this recommendation.

- A. The Report and Affidavit of Bidder on State Contracts Form will be revised to secure additional vendor information and require the documentation of the address of the companies' facilities as well as the number of regular employees.
- B. A program will be initiated to regularly update the Affidavit Reports.

Chapter III, Page 29

RECOMMENDATION #7

We recommend that Purchasing Division management review the preference system to determine if an overall benefit exists for the State.

COMMENTS

We concur with this recommendation.

The Purchasing Division has reviewed the preference system and determined that the existing statutes should be amended.

Legislation recommending specific modifications has been prepared for consideration of the Forty-Seventh Session and would allow the three percent (3%) preference to be afforded to only firms capable of documenting that the materials offered for sale are produced or manufactured in Montana.

Sincerely yours,



J. MICHAEL YOUNG

Acting Director

Department of Administration

DEPARTMENT OF INSTITUTIONS



THOMAS L. JUDGE, GOVERNOR

1539 ELEVENTH AVENUE

STATE OF MONTANA

(406) 449-3930

HELENA, MONTANA 59601

January 2, 1981

Senator Matt Himsl, Chairman
Legislative Audit Committee
Office of the Legislative Auditor
State Capitol
Helena, Montana 59601

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JAN 02 1981

MONTANA LEGISLATIVE AUDITOR

Dear Senator Himsl:


We have reviewed the report prepared by your staff on its performance audit of State Government Food Purchases, as it pertains to the Department of Institutions. The report contains several statements which we feel are in error.

First, the report asserts that it is our Department's policy to price meat products ten percent below market value. In fact, this has not been our policy since the 1979 legislature. 53-1-301(3) M.C.A. provides that our prices may not exceed those existing in the open market. Since the action of the 1979 Legislature, it has been our policy to price at the lower of cost or market value. This policy was followed in the prices established during FY 1979-80.

Second, the report asserts that our prices to user institutions exceeded those which would have been obtained through the Purchasing Division. We feel that our prices have resulted in a substantial savings throughout this Department. Using an index developed by averaging the prices paid by the University of Montana, Montana State University, Eastmont Training Center, and the School for the Deaf and Blind for similar products, and then comparing this index with actual sales to institutions, we calculated a cost savings department-wide of \$46,500 for meat and \$39,000 for dairy products for FY 1979-80. This does not include those costs paid by the Ranch which would otherwise have been borne by the General Fund, or the net income earned by the Ranch during that year.

The report provides a very welcome service and is sincerely appreciated. Our response to the recommendations is attached.

Sincerely,


for Lawrence M. Zanto, Director
Department of Institutions

LMZ:sd

STATE GOVERNMENT FOOD PURCHASES PERFORMANCE AUDIT
DEPARTMENT OF INSTITUTIONS RESPONSES

Recommendation #5A:

We recommend that the Department of Institutions use meat prices obtained through the Purchasing Division in the Prison Ranch meat pricing formula.

Response #5A:

The Department of Institutions will gladly use any meat prices obtained from the Purchasing Division, and include in our pricing formula those prices for comparable quantities and cuts. We have requested this in the past, but have always been required by the Purchasing Division to send our own staff to their office to gather the information. In general, we have found it easier to contact the Eastmont Training Center and the School for the Deaf and Blind ourselves.

Recommendation #5B:

We recommend that the Department of Institutions establish pricing formulas that reflect delivery costs to individual institutions.

Response #5B:

The Department of Institution agrees in principle with this recommendation, but does not feel it appropriate for implementation at this time. The majority of our delivery costs are fixed, and would not decrease if deliveries to outlying institutions were discontinued. For this reason, delivery costs are included in our pricing formula, but are allocated uniformly to all goods produced. Also, if deliveries to some institutions were discontinued, we would currently have

no alternative markets in which to sell our products. We feel that differential pricing may be more realistic when we are able to operate freely in an open market. In the meantime, we are continuously monitoring the effectiveness of sales and deliveries to maximize the profitability of the Department as a whole.

Recommendation #5C:

We recommend that the Department of Institutions review the cost effectiveness of sales and delivery of meat and dairy products to all institutions currently served by the prison ranch.

Response #5C:

We are in the process of completing this review, and hope to have this analysis completed prior to our report to the Legislature.

